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STATE OF MONTANA

DEPARTMENT OF INSTITUTIONS,

PINE HILLS SCHOOL,

REPORT ON AUDIT,

Conducted Under Contract By
Peat, Marwick, Mitchell & Co., CPA's.

Fiscal Year Ended June 30, 1975

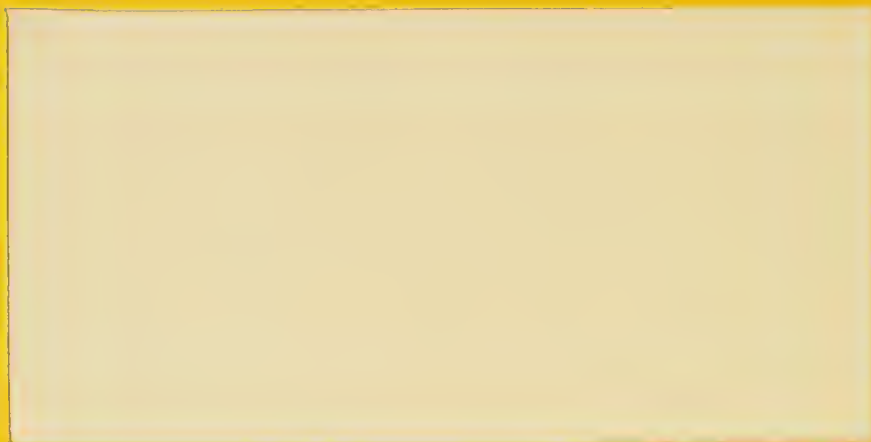


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STATE OF MONTANA
Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59601
406/449-3122

The Legislative Audit Committee
of the Montana State Legislature:

Transmitted herewith is the report on the audit of Pine Hills
School for the year ended June 30, 1975.

The audit was conducted by Peat, Marwick, Mitchell & Co., CPA's
of Billings. under a contract between the firm and our office. The
comments and recommendations contained in this report represent the
views of the firm and not necessarily the Legislative Auditor.

The agency's written response to the report recommendations is
included in the back of the audit report.

Respectfully submitted,

A handwritten signature in cursive script, reading "Morris L. Brusett".

Morris L. Brusett, C.P.A.
Legislative Auditor

PINE HILLS SCHOOL
(An Institution of the State of Montana)

NOV 0 1975

Financial Report

Year ended June 30, 1975

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PEAT, MARWICK, MITCHELL & CO.

CERTIFIED PUBLIC ACCOUNTANTS
204 TRANSWESTERN LIFE BUILDING
BILLINGS, MONTANA 59101

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the financial statements of the various funds of Pine Hills School (an institution of the State of Montana) for the year ended June 30, 1975 as listed in the accompanying table of contents. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Pine Hills School has not maintained a record of its general fixed assets, and accordingly a statement of general fixed assets, required by generally accepted accounting principles, is not included in the accompanying financial statements.

As discussed more fully in note 3 to the financial statements, the accompanying financial statements do not include \$28,300 of unrecorded expenditures as of June 30, 1975. Because of this departure from generally accepted accounting principles, encumbered appropriations and accrued support expenditures are understated in the accompanying balance sheets of the general fund and Federal revenue sharing (FPRA) by \$25,000 and \$3,300, respectively.

In our opinion, because of the material effect of the matter discussed in the preceding paragraph, the balance sheet does not present fairly the financial position of the general fund and Federal revenue sharing (FPRA) at June 30, 1975. However, in our opinion, the aforementioned financial statements present fairly the financial position of the other funds as listed in the accompanying table of contents at June 30, 1975 and the results of operations of all the funds as listed in the accompanying table of contents for the year then ended in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Supplementary data included in the Schedule have been subjected to the same auditing procedures and, in our opinion, are stated fairly in all material respects when considered in conjunction with the financial statements taken as a whole.

Peat, Marwick, Mitchell & Co.

October 16, 1975

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Combined Balance Sheet

June 30, 1975

<u>Assets and Other Debits</u>	General <u>Fund</u>	Federal Revenue <u>Sharing (FPRA)</u>	Interest and <u>Income (FPRA)</u>
	(See accompanying accountants' report for adverse opinion)		
Cash in State Treasury	\$ -	-	50,172
Cash in banks	1,000	-	-
Due from legacy and trust fund	-	-	8,105
Encumbered appropriation	<u>41,866</u>	<u>3,510</u>	<u>-</u>
	\$ <u>42,866</u>	<u>3,510</u>	<u>58,277</u>
 <u>Liabilities and Fund Balances</u>			
Accrued support expenditures	42,866	3,510	710
Due to boys	-	-	-
Fund balance	<u>-</u>	<u>-</u>	<u>57,567</u>
	\$ <u>42,866</u>	<u>3,510</u>	<u>58,277</u>

See accompanying notes to financial statements.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Combined Balance Sheet, Continued

June 30, 1975

<u>Assets and Other Debits</u>	Federal and Private <u>Revenue Account</u>	Long Range <u>Building Fund</u>	Agency Fund <u>(note 1)</u>
Cash in State Treasury	\$ 17,426	-	-
Cash in banks	-	-	16,669
Due from legacy and trust fund	-	-	-
Encumbered appropriation	-	<u>53,417</u>	-
	\$ <u>17,426</u>	<u>53,417</u>	<u>16,669</u>
 <u>Liabilities and Fund Balance</u>			
Accrued support expenditures	3,346	-	-
Due to boys	-	-	16,669
Fund balance	<u>14,080</u>	<u>53,417</u>	-
	\$ <u>17,426</u>	<u>53,417</u>	<u>16,669</u>

See accompanying notes to financial statements.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Combined Statement of Revenues - Budget and Actual

Year ended June 30, 1975

	<u>General Fund</u>		<u>Federal Revenue Sharing (FPRA)</u>	
	<u>Budget</u>	<u>Actual</u>	<u>Budget</u>	<u>Actual</u>
Reimbursements:				
Federal	\$ 1,490	-	-	-
Subsistence charges	6,000	4,524	-	-
Sale of property	410	74	-	-
Rentals and leases	2,700	2,530	-	-
Federal grants	-	-	-	-
Interest	-	-	-	-
Income from state lands	-	-	-	-
	<u>\$ 10,600</u>	<u>7,128</u>	<u>-</u>	<u>-</u>

See accompanying notes to financial statements.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Combined Statement of Revenues - Budget and Actual, Continued

Year ended June 30, 1975

	Interest and Income (FPRA)		Federal and Private Revenue Account	
	<u>Budget</u>	<u>Actual</u>	<u>Budget</u>	<u>Actual</u>
Reimbursements:				
Federal	\$ -	-	-	-
Subsistence charges	-	-	-	-
Sale of property	-	-	-	-
Rentals and leases	-	-	-	-
Federal grants	-	-	65,000	81,374
Interest	28,000	35,610	-	-
Income from state lands	<u>30,555</u>	<u>40,823</u>	-	-
	<u>\$ 58,555</u>	<u>76,433</u>	<u>65,000</u>	<u>81,374</u>

See accompanying notes to financial statements.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Combined Statement of Expenditures - Budget and Actual

Year ended June 30, 1975

	General Fund		Federal Revenue Sharing (FPRA)	
	<u>Budget</u>	<u>Actual</u>	<u>Budget</u>	<u>Actual</u>
Administration program	\$ 80,769	80,000	41,000	40,857
Care and custody program	217,751	217,278	200,000	200,000
General services and physical plant program	158,824	154,277	200,000	196,815
Education and training program	268,885	255,630	6,490	6,490
Farm program	55,909	54,976	25,000	25,000
Clinical services program	<u>123,017</u>	<u>116,994</u>	<u>50,000</u>	<u>50,000</u>
	<u>\$ 905,155</u>	<u>879,155</u>	<u>522,490</u>	<u>519,162</u>

See accompanying notes to financial statements.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Combined Statement of Expenditures - Budget and Actual, Continued

Year ended June 30, 1975

	Interest and Income (FPRA)		Federal and Private Revenue Account	
	<u>Budget</u>	<u>Actual</u>	<u>Budget</u>	<u>Actual</u>
Administration program	\$ -	-	434	425
Care and custody program	27,352	27,352	-	-
General services and physical plant program	27,710	27,652	3,170	-
Education and training program	-	-	52,508	47,927
Farm program	-	-	-	-
Clinical services program	<u>4,439</u>	<u>4,439</u>	<u>41,340</u>	<u>37,677</u>
	\$ <u><u>59,501</u></u>	<u><u>59,443</u></u>	<u><u>97,452</u></u>	<u><u>86,029</u></u>

See accompanying notes to financial statements.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Combined Statement of Changes in Fund Balances

Year ended June 30, 1975

	<u>General Fund</u>	<u>Federal Revenue Sharing (FPRA)</u>	<u>Interest and Income (FPRA)</u>
Fund balance at July 1, 1974	\$ -	-	40,577
Receipts and additions:			
Appropriation for operating purposes	905,155	522,490	-
Revenues	<u>7,128</u>	<u>-</u>	<u>76,433</u>
	<u>912,283</u>	<u>522,490</u>	<u>76,433</u>
Expenditures:			
Expenditures	879,155	519,162	59,443
Reversions to state	<u>33,128</u>	<u>3,328</u>	<u>-</u>
	<u>912,283</u>	<u>522,490</u>	<u>59,443</u>
Fund balance at June 30, 1975	\$ <u>-</u>	<u>-</u>	<u>57,567</u>

See accompanying notes to financial statements.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Combined Statement of Changes in Fund Balances, Continued

Year ended June 30, 1975

	Federal and Private <u>Revenue Account</u>	Long Range <u>Building Fund</u>
Fund balance at July 1, 1974	\$ 18,735	148,417
Receipts and additions:		
Appropriation for operating purposes	-	-
Revenues	<u>81,374</u>	<u>-</u>
	81,374	148,417
Expenditures:		
Expenditures	86,029	-
Reversions to state	<u>-</u>	<u>95,000</u>
	86,029	95,000
Fund balance at June 30, 1975	\$ <u>14,080</u>	<u>53,417</u>

See accompanying notes to financial statements.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Notes to Financial Statements

June 30, 1975

(1) Summary of Significant Accounting Policies

The preceding financial statements reflect the financial position and operations of Pine Hills School except for a statement of general fixed assets which is not maintained. The financial transactions for the school are recorded in different types of funds of the State of Montana. Pine Hills School is a discrete entity and financial data pertaining to the school have been combined into a set of financial statements in order to provide an understanding of the school's operations.

The different funds included in the financial statements and their purpose are:

General Fund - To account for all Pine Hills School revenues and expenditures not included in any of the other funds.

Federal and Private Revenue Account - To account for governmental grants received other than those grants for which a separate fund has been established and account for the expenditures against the grants.

Interest and Income Federal and Private Revenue Account (Interest and Income FPRA) - To account for the interest and income from the land grant given to the state under the Enabling Act for the purpose of supporting a state industrial school. This land given to the state under the Enabling Act and all moneys received from the sale of these lands are held as permanent funds in the legacy and trust fund which is administered by the Department of State Lands. Actual income from this portion of the legacy and trust fund is made available for the maintenance and support of Pine Hills School.

Federal Revenue Sharing Federal and Private Revenue Account (Federal Revenue Sharing FPRA) - To account for the Federal revenue sharing monies received from the state as a secondary recipient and account for the expenditures against such funds.

Long Range Building Fund - To reflect appropriations in the state long range building fund for Pine Hills School capital projects and expenditures against such appropriations.

Agency Fund - To reflect cash held for boys committed to Pine Hills School and reflect the corresponding liability.

The accounting policies of Pine Hills School conform to generally accepted accounting principles as applicable to governmental units. The following is a summary of the more significant of such policies:

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Notes to Financial Statements, Continued

(1) Summary of Significant Accounting Policies, Continued

Fund Accounting

The accounts of the school are organized on the basis of funds, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for by providing a separate set of self-balancing accounts which comprise its assets, liabilities, reserves, fund balance, revenues and expenditures.

Basis of Accounting

The modified accrual basis of accounting, under which expenditures are recorded when the liability is incurred and revenues are recorded when received in cash unless susceptible to accrual, i.e. measurable and available to finance the school's operations, or of a material amount and not received at the normal-time of receipt, is followed for all funds.

The accompanying financial statements reflect an adjustment that is not recorded on the books of the interest and income (FPRA) fund. It was not practical for the school to record the adjustment since it affects other state agencies. The adjustment is for interest due from the legacy and trust fund. The transfer of quarterly cash basis interest on advances from the legacy and trust fund to the Board of Investments was not recorded on a timely basis at June 30, 1975 and at June 30, 1974 and accordingly were recorded in the subsequent years. The following is a reconciliation of the amounts recorded on the books of the interest and income (FPRA) fund at June 30, 1975 with the amounts reflected in the financial statements:

	<u>Debit (Credit)</u>		
	Due from		
	Legacy and	Fund	
	Trust Fund	Balance	Revenues
Per books June 30, 1975	\$ -	(49,462)	(82,036)
Adjustment to reflect effect of recording interest for the quarter ended June 30, 1974 in the proper year			13,708
Adjustment to reflect effect of re- cording interest for the quarter ended June 30, 1975 in the proper year	<u>8,105</u>	<u>(8,105)</u>	<u>(8,105)</u>
Balance as reported in the financial statements	\$ <u>8,105</u>	<u>(57,567)</u>	<u>(76,433)</u>

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Notes to Financial Statements, Continued

(1) Summary of Significant Accounting Policies, Continued

Encumbrances

Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation, is employed in all funds. The balances in the reserve for encumbrances account which is negligible at June 30, 1975 is included in accrued support expenditures.

Appropriations

Appropriations in the general fund and Federal revenue sharing (FPRA) are made by the legislature for operating purposes of Pine Hills School. Expenditures against these appropriations are funded by the corresponding funds at the state level. Unexpended or unencumbered balances in these appropriations revert to the respective state funds at year end.

Appropriations in the long range building fund are made by the legislature for capital projects of Pine Hills School. Appropriations in this fund continue until the completion of the project unless a specific time limit has been set by the legislature. Expenditures against these appropriations are funded by the corresponding funds at the state level. At time of completion of a project or expiration of a time limit the appropriation reverts to the unappropriated fund balance in the state long range building fund.

Inventories

Inventories are expensed at the time of purchase.

General Fixed Assets

The school has not maintained a record of its general fixed assets. Assets purchased are recorded as expenditures in the various funds in the year of purchase or encumbrance.

Depreciation is not provided on general fixed assets.

Farm Operation

The farm operation is a separate program of the school which consists of a rehabilitation program for the boys and at the same time defrays food costs of the school.

Vacation Pay and Sick Pay

The value of unused vacation and unused sick leave accumulated by employees is not recorded as a liability. Each permanent employee can accumulate and carryover a maximum of two years vacation into a new calendar year. Unused accumulated vacation is redeemed in cash upon termination of employment. The amount of accumulated leave at June 30, 1975 was not readily determinable.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Notes to Financial Statements, Continued

(2) Retirement Plans

The State of Montana has two contributory retirement plans covering substantially all employees of Pine Hills School. Instructional employees are eligible for the Teachers Retirement System and other employees are eligible for the Public Employees Retirement System. Pine Hills School employer contributions for the year ended June 30, 1975 for all funds was \$50,534. The unfunded past service costs and the actuarially computed value of vested benefits is not readily available for members of the plans employed at Pine Hills School.

(3) Unrecorded Liabilities

The school had received certain goods or services prior to June 30, 1975, however, the related amounts were not recorded until fiscal 1976. If these amounts had been reflected in the financial statements, the balance sheets of the general fund and the Federal revenue sharing (FPRA) would include additional accrued support expenditures of \$25,000 and \$3,300, respectively and encumbered appropriations of \$25,000 and \$3,300, respectively at June 30, 1975. Accordingly expenditures would have increased and reversions of appropriations to the state would have decreased for the year ended June 30, 1975 by \$25,000 in the general fund and \$3,300 in the sharing (FPRA). The effect of recording these amounts on the statement of expenditures would be as follows:

	Per financial statements	Unrecorded expenditures	Actual expenditures
General Fund:			
Administration program	\$ 80,000	-	80,000
Care and custody program	217,278	-	217,278
General services and physical plant program	154,277	6,600	160,877
Education and training program	255,630	-	255,630
Farm program	54,976	18,400	73,376
Clinical services program	116,994	-	116,994
	<u>\$ 879,155</u>	<u>25,000</u>	<u>904,155</u>
Federal Revenue Sharing (FPRA):			
Administration program	40,857	-	40,857
Care and custody program	200,000	-	200,000
General services and physical plant program	196,815	3,300	200,115
Education and training program	6,490	-	6,490
Farm program	25,000	-	25,000
Clinical services program	50,000	-	50,000
	<u>\$ 519,162</u>	<u>3,300</u>	<u>522,462</u>

The unrecorded expenditures are not considered material to the total expenditures of each fund.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Notes to Financial Statements, Continued

(4) Accounts not on Statewide Budgeting and Accounting System

The cash in the agency fund represents primarily cash held in trust for the boys committed to Pine Hills School. This cash and the corresponding liability are not recorded in the statewide budgeting and accounting system, but have been reflected in the financial statements for reporting purposes.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Schedule of Expenditures by Program

Year ended June 30, 1975

	<u>Administration Program</u>	<u>Care and Custody Program</u>	<u>General Services and Physical Plant Program</u>
Personal Services:			
Salaries, wages and employee benefits	\$ <u>102,482</u>	<u>418,789</u>	<u>204,254</u>
Operating expenses:			
Contracted services	235	13,702	2,306
Supplies and materials	2,445	456	94,008
Communications	13,772	5	503
Travel	1,132	-	88
Rent	223	2,338	166
Utilities	-	-	47,379
Repairs and maintenance	449	-	20,691
Other expenses	<u>374</u>	<u>8,740</u>	<u>35</u>
	<u>18,630</u>	<u>25,241</u>	<u>165,176</u>
Capital outlay:			
Equipment and livestock	<u>170</u>	<u>600</u>	<u>9,314</u>
	<u>\$ 121,282</u>	<u>444,630</u>	<u>378,744</u>

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Schedule of Expenditures by Program, Continued

Year ended June 30, 1975

	Education and Training <u>Program</u>	Farm <u>Program</u>	Clinical Services <u>Program</u>
Personal Services:			
Salaries, wages and employee benefits	\$ <u>279,257</u>	<u>47,440</u>	<u>195,022</u>
Operating expenses:			
Contracted services	1,081	660	1,615
Supplies and materials	21,711	24,616	5,190
Communications	-	11	-
Travel	580	153	5,877
Rent	161	1,198	1,028
Utilities	-	1,183	-
Repairs and maintenance	1,616	3,382	279
Other expenses	<u>1,361</u>	<u>-</u>	<u>43</u>
	<u>26,510</u>	<u>31,203</u>	<u>14,032</u>
Capital outlay:			
Equipment and livestock	<u>4,280</u>	<u>1,333</u>	<u>56</u>
	\$ <u><u>310,047</u></u>	<u><u>79,976</u></u>	<u><u>209,110</u></u>

PINE HILLS SCHOOL
(An Institution of the State of Montana)

AUDITORS' OBSERVATION AND COMMENTS ON
ACCOUNTING PROCEDURES AND INTERNAL CONTROL

Introduction

The primary purpose of our examination of the financial statements of the various funds of Pine Hills School for the period ended June 30, 1975 was to enable us to form an opinion as to the financial position of the various funds of Pine Hills School and the results of operations of such funds for the period then ended. As a part of our examination, we reviewed and tested the School's system of internal accounting control to the extent considered necessary to evaluate the system as required by generally accepted auditing standards. The purpose of the evaluation is to establish a basis for reliance thereon in determining the nature, timing and extent of auditing procedures that are necessary for expressing an opinion on the financial statements.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of the Pine Hills School's system of internal accounting control for the year ended June 30, 1975 would not necessarily disclose all weaknesses in the system. However, such study and evaluation disclosed the following conditions that we believe merit attention.

Cash

The school maintains four local bank accounts in Miles City. The balances in these accounts at June 30, 1975 were:

Revolving fund	\$ 1,000
Transportation fund	359
Canteen fund	307
Boys' fund	<u>16,003</u>

The transportation, canteen and boys' funds are not recorded on the statewide budgeting and accounting system. The transportation fund is used

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Cash, Continued

to pay for transportation costs when a boy is sent home. These costs, in most cases, are reimbursed by the boy's home county. The canteen fund is used to purchase equipment and supplies for the school canteen. The canteen sells concessions to the boys and to basketball game spectators at a small profit. The boys' fund consists of: the boys' personal money; money received from contributions; proceeds from the sale of cigarettes and hobby materials to boys; and reimbursements received from parents for boy's glasses, dental work, postage and damages. The boys are required to sign transfer vouchers when they purchase items with their personal money. The reimbursements received from parents are transferred to the State Treasury three or four times a year at which time Pine Hills School expenditures are reduced for the reimbursements.

We recommend that the transportation, canteen and boys' funds be recorded on the statewide budgeting and accounting system along with the related liability and equity accounts. If these accounts are so recorded, it will be necessary to request appropriations for expenditures from the accounts. We also recommend that reimbursements received by the school be remitted to the State Treasurer at least monthly.

We recommend that one more person be authorized to sign checks so that the practice of obtaining one signature on a blank check can be eliminated. Dual signatures are required for all checks written on the four accounts; however, we noted that there were several revolving fund checks signed in blank by one authorized signatory. We were told that this is done whenever two of the three authorized signatories are scheduled to be out of town at the same time.

Also we noted several amounts carried in the boys' fund for boys who are no longer at Pine Hills School. We suggest the school try to locate these boys and give them their money. If the boys can't be located we suggest this money be transferred to a separate account for control purposes. Also, we suggest that a procedure should be developed to allow boys to receive all money they have coming at the time of discharge from the school.

Stores Inventory

Physical inventories are taken on a spot-check basis by the stores employees who are responsible for controlling the inventory and maintaining the perpetual inventory records. To strengthen internal control we suggest the following:

- 1) The business manager should supervise the taking of the physical inventories, make test counts and follow-up on significant differences between the physical count and the count as recorded on the perpetual cards.

PINE HILLS SCHOOL
(An Institution of the State of Montana)

Stores Inventory, Continued

- 2) Complete physical inventories should be taken at least annually. An alternative to counting all the inventory in one session would be to physically count major sections of the inventory at different times during the year ensuring that all sections have been physically counted at least once during the year.
- 3) Written instructions for taking the physical should be prepared for the employees to follow:

At present, the same employee initiates requisitions for purchases, receives the commodities, maintains the perpetual inventory records and issues the commodities from stores inventory. Internal control would be strengthened if maintenance of the perpetual inventory records and requisitioning function were segregated from the physical control of the assets.

We were informed by the school employees that there are certain inventory items on hand that the school has no use for or are obsolete. We suggest the school physically segregate and prepare a list of these items, then notify the Department of Institutions of these excesss or obsolete items so they can be sold or disposed of in order to make space available for current needs.

Fixed Assets

Our review of fixed assets disclosed the following weaknesses:

1. A complete physical inventory of fixed assets has not been taken for several years; however, the school is presently in the process of taking a complete physical inventory. Management memo 70-17 requires annual inventories be taken.
2. Identifying numbers cannot be found on many items because the numbers have fallen off.
3. Responsibility for fixed asset items is not fixed with particular custodians.
4. The fixed assets are not under general ledger control.

In order to strengthen internal control and provide proper accounting over fixed assets we recommend:

1. The school take a complete physical inventory of all fixed assets and bring the property records up to date and continue to take annual physical inventories. Inventory workpapers should be retained for audit purposes.
2. All fixed assets not permanently attached be identified with some type of semi-permanent label that cannot be readily removed.

PINE HILLS SCHOOL
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Fixed Assets, Continued

3. Develop a systematic numbering system for identifying the property and record the identifying number on the label attached to the fixed asset and on the permanent property records.
4. Property records be updated monthly for purchases, sales, transfers, trade-ins, or retirements of fixed assets.
5. The school set up a general fixed asset group of accounts to record the cost of all fixed assets owned and obtain general ledger control over these assets. This will require determining the proper carrying value of these assets in accordance with generally accepted accounting principles.
6. Responsibility for the physical control of fixed assets should be fixed with one individual.
7. The list of fixed assets be reviewed annually with Department of Administration to insure that adequate but not excessive insurance is in force.

Farm Operation

We suggest Pine Hills School develop more finite cost centers for accumulating costs of the farm operation and more detailed and more complete production and usage reports. This will allow the school to establish more accurate information on the cost of the farm operation and on the resultant benefit of defraying food costs (consumable food products raised). We suggest that the school request help from the State in developing the cost centers and production and usage reports.

Our understanding is that transfers of raised products (crops and food) from Pine Hills to other institutions is now on a very limited basis. If these transfers become significant, we suggest that Pine Hills School set up an enterprise fund for the farm operation so the school is allowed to recognize the benefit of these transfers.

Grant Records

During our review of grants we noted the school is not currently maintaining subsidiary grant records for all grants. We recommend that the school set up subsidiary records by grant for all grants, detailing information such as: total grant, cash received, cash expended, unexpended balance and matching funds expended. These detail grant records should be reconciled monthly to the general ledger of the Federal and Private Revenue Account Fund. Also we suggest the school request from the Department of Administration that each grant be assigned a separate subcoding (or appropriation number) on the statewide budgeting and accounting system, to allow cash receipts and expenditures to be easily identified by grant.

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Equipment Purchases

The State policy for recording equipment expenditures as stated in management memo 2-75-5 is: "Requisitions for equipment may be charged against the fiscal year in which the equipment was budgeted." Purchase orders issued by the State Purchasing Bureau for a tractor and mulcher for Pine Hills School stated "this a July order.. Invoices dated prior to July 1, 1975 cannot be processed for payment". Pine Hills School received the tractor and mulcher on May 17, 1975 and commenced using immediately (fiscal year 1975) but did not record the expenditure until August 1975 (fiscal year 1976) since the equipment was budgeted in the 1976 appropriation. This amounts to an unrecorded liability at June 30, 1975. Also it circumvents the appropriation procedure in that the equipment has been ordered and received before the appropriation is effective.

Generally accepted accounting principles require that expenditures be recognized in the year incurred (at the time title passes which is usually at time of delivery) or in the year encumbered (at the time the commitment is made) whichever is first.

We suggest the State adopt a policy recording equipment expenditures consistent with generally accepted accounting principles.

Monitoring Expenses

The school had an unrecorded liability for payroll of approximately \$6,200 at June 30, 1975. This resulted from the fact that the school overspent their authority in the revenue sharing fund at year end when payroll was accrued and the accrual entry was automatically rejected by the computer. The school did not resubmit the corrected entry (charging general fund for the overexpenditure) until after the post closing run had been made.

The school should monitor their expenses more closely and be more timely in submitting entries to the state for inclusion in the statewide budgeting and accounting system.

Proper Recognition of Expenses

The school received approximately \$3,200 of food supplies in April and May of 1975. According to school employees, part of these supplies had been used by June 30, 1975. These supplies were not paid for or accrued at June 30, 1975. Management memo 2-75-5 and generally accepted accounting principles require that purchases of supplies be recorded in the year received. These supplies were not recorded as a liability at June 30, 1975 by the school since the purchase order was against the fiscal 1976 budget. Effectively, the school was spending from the 1976 fiscal year budget in fiscal 1975. If additional supplies are needed in excess of the budget, the school should follow the State procedure by submitting a budget amendment request.

Expenditure Cut-off at Year End

The fiscal year-end for all State agencies is June 30. The agencies have until approximately July 17 to get all accruals and closing entries to

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Expenditure Cut-off at Year End, Continued

the State to be recorded in the statewide budgeting and accounting system (SBAS). Since SBAS is following the encumbrance system of accounting this should be sufficient time to get all entries to the computer. However, SBAS has a provision for late entries to be recorded against a prior years appropriation up to approximately November 15th of the subsequent fiscal year. These late entries are reflected in the subsequent year in account 5208 "prior year expenditure adjustment." Effectively this allows the agencies to spend in the current year against a prior years appropriation.

We suggest that all agencies be instructed to obtain accurate cut-offs as of June 30, in the July cut-off and all appropriations for the prior year closed as of that time unless special authorization for a continuing appropriation is obtained.

Payroll

During our review of payroll we noted the following weaknesses:

1. The payroll clerk prepares the payroll and distributes the payroll warrants which could allow a fictitious employee to be set up on the payroll.
2. The payroll being returned from central payroll at Helena was not always reviewed by someone outside of the payroll department.
3. Payroll warrants are given to supervisors for distribution to employees.

To strengthen internal control in the area of payroll we suggest payroll warrants coming from central payroll should not be returned to the person preparing the payroll but delivered to a different person who would be responsible for delivering the payroll warrants. This individual should personally deliver the warrants to each employee or have the employees pick up the warrants from the individual at a central point. Payroll warrants should not be released until the payroll clerk and one other responsible official have reviewed the payroll and are satisfied the payroll is correct. The individuals reviewing the payroll should initial the payroll run as an indication of their review.

Personnel Files

During our payroll procedures test we noted many items that are normally kept in an employee personnel file were filed in the payroll department in chronological order. This makes it very difficult to locate any of these items.

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Personnel Files, Continued

A personnel file should include such things as: employee application; employment agreement; wage authorizations; employee withholding form, and authorization for deductions for such things as insurance, retirement plans, etc. We suggest the school start placing these items in the personnel file for ease of review and a complete history of each individual.

Interest Income from the Legacy and Trust Fund

The quarterly interest from the legacy and trust fund is not being recorded on timely basis and accordingly revenues in the interest and income fund are being misstated. This amounted to an over statement of income of approximately \$5,600 for fiscal 1975, which was adjusted in the financial statements for June 30, 1975.

An effort should be made by the various State departments involved to get the interest income from the legacy and trust fund recorded in the proper year at year end.

Reserve for Encumbrances

The statewide budgeting and accounting system (SBAS) follows the encumbrance system of accounting, recording commitments or purchase orders as an encumbrance against appropriations at the time the commitment is made. When the goods or services have been received and the commitment becomes a true liability the encumbrance entry is reversed and the liability is set up in accrued support expenditures. At year end however, SBAS has been closing the balance in the reserve for encumbrance account (purchase orders and commitments still outstanding but goods or services not received) to the accrued support expenditures account. This is comingling actual liabilities with potential liabilities for commitments. This causes difficulty in reconciling accounts payable to vendors and does not allow good control over inventories. We suggest that reserve for encumbrances be left as a separate line item in the general ledger at year end with a separate detail run of outstanding encumbrances supporting the line item.

Audit Trail of Statewide Budgeting and Accounting System

The statewide budgeting and accounting system presently does not leave a very adequate audit trail. Pine Hills School is finding it necessary to keep certain hand posted records. Also we encountered certain difficulties in analyzing accounts.

We feel the audit trail could be greatly improved if the general ledger was set up on a more conventional basis that reflects by general ledger account: the balance previous month; individual debits and credits to the account with references to the source run or source document; and balance at the end of the month.

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U.S.D.A. Donations

The school received donated food under a program of the U. S. Department of Agriculture. These donations of food are not reflected in the accounts of the school. Although these donations were not material in fiscal 1975, we feel the school should record these donations at fair market value at the time of receipt and also record the related expense. This will gross up the revenues and expenses of the school and more accurately reflect food costs.

Contract with Local Creamery

During our review of the farm operations we noted Pine Hills School has a contract with a local creamery to trade cream for ice cream at current market prices. We were informed this agreement has not been approved by the State,

We suggest that the school obtain the necessary approval for this agreement from the State and in the future obtain approval before entering into any similiar barter type transactions.

Employee Meals

The school is currently providing the noon meal for employees and allowing employees to purchase an additional meal each day for thirty-five cents. There is no indication of this employee benefit in the employee handbook or in the employment agreements though we understand that this is a departmental policy. We suggest this benefit be incorporated in the employee handbook.

The cost of the employee meals is currently recorded in the food program. According to the school's current analyses of food costs, meals are costing approximately sixty cents (including preparation). We feel the cost of these meals should be recorded as an employee benefit in personnel services of each program rather than as a cost of the food program.

It should be noted that this letter, by its nature, is critical in that it contains only our comments and recommendations on deficiencies observed in the course of our examination. It does not include our observations on the many strong features of the institutions system of internal control also observed.

We have not reviewed the internal control of the school since October 16, 1975, which is the date of completion of our field work.

* * * * *

Please contact us if you require additional information or clarification of any of the matters set forth herein.

AGENCY RESPONSE

State of Montana

Department of Institutions



GOVERNOR
THOMAS L. JUDGE

DIRECTOR
ROBERT H. MATTSON



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Helena, 59601

December 9, 1975

Legislative Audit Committee
of the Montana State Legislature
Office of the Legislative Auditor
State Capitol
Helena, MT 59601

Gentlemen:

We have reviewed the audit report prepared by Peat, Marwick, and Mitchell and Company on Pine Hills School for Boys. Our review was made in cooperation with Dr. Don Holladay, Superintendent of Pine Hills School for Boys.

The report provides a very welcome service and is sincerely appreciated.

Our response to recommendations is attached.

Sincerely,

A handwritten signature in cursive script that reads 'Robert H. Mattson'.

Robert H. Mattson
Director

RHM/jn
Enc.

Opinion and Notes to Financial Statements

Comments: The agency and the Department wish to respond to the situation which has led to the adverse opinion on the balance sheet of two funds.

The major portion (\$18,400) of the \$28,300 involved was the result of the agency following State regulation (Montana Administrative Manual MM 2-75-5) which the auditor felt was not in compliance with generally accepted accounting principles. See Opinion, page 1, paragraph 3, and Equipment Purchases section, page 21. The Department will refer the matter to the Department of Administration.

The next largest portion (\$6,700) was a payroll charge which was corrected in the proper time frame by the agency. See response to Monitoring Expenses, page 21.

Cash

Comment: The four local accounts have been approved by the Department of Administration and the State Treasurer. However, an analysis has been initiated regarding their use as detailed below.

Recommendation - Page 18

We recommend that the transportation, canteen and boys' funds be recorded on the statewide budgeting and accounting system along with the related liability and equity accounts. If these accounts are so recorded, it will be necessary to request appropriations for expenditures from the accounts.

The transportation fund will be closed to the Contingency Fund. Henceforth, advances and abatements for boys' travel will be transacted through that fund. The Department of Administration has agreed to this method and a reconciliation form to report these activities will be developed to fully disclose the fund activity.

Canteen activities will be analyzed. The Department has contacted the Department of Administration and the Office of Budget and Program Planning for assistance in developing policies and procedures for agencies which are remote both from Helena and major business areas. The remoteness as well as the materiality of the amounts and the number of transactions involved will be considered in the development of a canteen reporting system. Strict accountability to the resident is the goal regardless where the monies are held.

The residents' accounts will continue to be maintained in the approved local bank account until the question regarding these accounts being "state funds" or not is resolved. The issue presents itself in the law at Section 82A-204, R.C.M. 1947. The Department of Administration's Accounting Division and Investments Division

have indicated they believe the residents' monies do not appear to be "state funds" and thereby would not be deposited into the State Treasury.

Recommendation - Page 18

We also recommend that reimbursements received by the school be remitted to the State Treasurer at least monthly.

Reimbursements received by the school will be abated immediately if General Fund dollars provided the initial goods or service.

Recommendation - Page 18

We recommend that one more person be authorized to sign checks so that the practice of obtaining one signature on a blank check can be eliminated.

One employee has been added to the signatory file for the non-treasury accounts. The practice of presigning checks will not continue.

Suggestion - Page 18

...We noted several amounts carried in the boys' fund for boys who are no longer at Pine Hills School. We suggest the school try to locate these boys and give them their money. If the boys can't be located, we suggest this money be transferred to a separate account for control purposes. Also, we suggest that a procedure should be developed to allow boys to receive all money they have coming at the time of discharge from the school.

The Department and the institution will take the necessary action to locate the prior residents and/or properly dispose of these unclaimed monies. Authorization for a separate account will be requested.

The institution has made attempts at locating these residents and will continue to do so. When a boy is discharged, the institution will close out his personal account and send the check to him with his discharge. The institution will still have some boys who cannot be located due to lack of address at time of discharge.

Stores Inventory

Comment: The institution believes that these suggestions must refer solely to food. It should be noted that no specific State procedure is required regarding record keeping and physical inventories for items valued under \$100. However, the institution and Department agree that even though inventory items have been correctly charged to current year's appropriations, there should be controls established which will give adequate information as to the receipt and disposition of supplies which are significant in total value. Stores inventory procedures will be strengthened.

Suggestion - Pages 18 and 19

To strengthen internal control we suggest the following:

1. The business manager should supervise the taking of the physical inventories, make test counts and follow-up on significant differences between the physical count and the count as recorded on the perpetual cards.
2. Complete physical inventories should be taken at least annually. An alternative to counting all the inventory in one session would be to physically count major sections of the inventory at different times during the year ensuring that all sections have been physically counted at least once during the year.
3. Written instructions for taking the physical should be prepared for the employees to follow.

The administrative assistant has been assigned responsibility for supervising the physical inventory. A complete inventory is currently being taken. The administrative assistant is also responsible for all follow-up work in reconciling the physical count to the perpetual records. A written procedure will be devised for employees to follow.

Suggestion - Page 19

Internal control would be strengthened if maintenance of the perpetual inventory records and requisitioning function were segregated from the physical control of the assets.

Due to limited staff, optimal separation of duties in this area is extremely difficult; however, the institution has been complying with this procedure as follows: The employee initiating the requisitions cannot approve such requests. The business manager reviews the requisitions as to propriety and adequacy of budgeted authority as necessary. Only the superintendent may then approve requisitions.

Suggestion - Page 19

We suggest the school physically segregate and prepare a list of these items (of no use or obsolete), then notify the Department of Institutions of these excesses or obsolete items so they can be sold or disposed of in order to make space available for current needs.

The institution is preparing a detailed surplus list to reduce its inventory of excess or obsolete items.

Fixed Assets

Recommendation - Page 19

In order to strengthen internal control and provide proper accounting over fixed assets we recommend:

1. The school take a complete physical inventory of all fixed assets and bring the property records up to date and continue to take annual physical inventories. Inventory workpapers should be retained for audit purposes.

The institution is in the process of taking a complete physical inventory and has requested the administrative assistant to give this matter immediate attention. The administrative assistant has been further instructed to retain inventory workpapers for audit purposes.

The three janitors who have responsibility for various buildings will work under the supervision of the administrative assistant in performing the physical inventory in their areas.

Recommendation - Page 19 and 20

2. All fixed assets not permanently attached be identified with some type of semi-permanent label that cannot be readily removed.
3. Develop a systematic numbering system for identifying the property and record the identifying number on the label attached to the fixed asset and on the permanent property records.

The Department of Administration is presently in the process of preparing guidelines for property management. A portion of the guidelines are reportedly addressing a statewide system of numbering fixed assets; the institution and Department are awaiting further detail regarding the Department of Administration's proposals.

The institution has ordered an Etch-O-Matic in preparation of identifying each item with a permanent label, but before any system is implemented, it will be coordinated with the Department of Administration.

Recommendation - Page 20

4. Property records be updated monthly for purchases, sales, transfers, trade-ins, or retirements of fixed assets.
5. The school set up a general fixed asset group of accounts to record the cost of all fixed assets owned and obtain general ledger control over these assets. This will require determining the proper carrying value of these assets in accordance with generally accepted accounting principles.

The agency will attempt to determine the original costs for fixed assets and record those costs. The business manager, in coordination with the administrative assistant, will keep property records updated.

Due to the limited availability of staff, placing the total responsibility of establishing a General Fixed Asset group of accounts, without assistance from the Department of Administration, would impose an undue burden on the institution. Therefore, the Department will try to coordinate the responsibility of recording and determining proper carrying value of Fixed Assets with the Department of Administration in the most timely manner.

Recommendation - Page 20

6. Responsibility for the physical control of fixed assets should be fixed with one individual.

The administrative assistant has been assigned the responsibility for physical control of fixed assets.

Recommendation - Page 20

7. The list of fixed assets be reviewed annually with Department of Administration to insure that adequate but not excessive insurance is in force.

When a perpetual inventory system is devised and implemented by the Department of Administration, such a review will be an easier task. However, determining the proper carrying values at this point in time will be extremely difficult and time-consuming. The Department believes the suggested function is very important and will contact the Insurance Division of the Department of Administration to determine the most reasonable means of complying, considering the current staff at the institution and the absence of computer capability.

Farm Operation

Suggestion - Page 20

We suggest Pine Hills School develop more finite cost centers for accumulating costs of the farm operation and more detailed and more complete production and usage reports. We suggest that the school request help from the State in developing the cost centers and production and usage reports.

Presently Pine Hills has three cost centers in the farm operation: beef cattle, dairy and farm crops. The institution and the Department will consider the adaptability of the new prison revolving fund system to that institution. The Department will work with Pine Hills and will seek the assistance of other agencies where necessary in developing such systems.

Suggestion - Page 20

If these transfers (raised products transferred to other institutions) become significant, we suggest that Pine Hills School set up an enterprise fund for the farm operation so the school is allowed to recognize the benefit of these transfers.

The feasibility of setting up an enterprise fund for the farm operation will be considered. Also see response above.

Grant Records

Recommendation - Page 20

We recommend that the school set up subsidiary records by grant for all grants, detailing information such as: total grant, cash received, cash expended, unexpended balance and matching funds expended. These detail grant records should be reconciled monthly to the general ledger of the Federal and Private Revenue Account Fund. Also we suggest the school request from the Department of Administration that each grant be assigned a separate subcoding (or appropriation number) on the statewide budgeting and accounting system, to allow cash receipts and expenditures to be easily identified by grant.

The Department will work with the institution on maintaining proper grant records. Also the Department will work with the Department of Administration to adequately facilitate identification of grant activities in SBAS.

Equipment Purchases

Suggestion - Page 21 We suggest the State adopt a policy recording equipment expenditures consistent with generally accepted accounting principles.

This suggestion will be referred to the Department of Administration.

Monitoring Expenses

Recommendation - Page 21

The school should monitor their expenses more closely and be more timely in submitting entries to the state for inclusion in the statewide budgeting and accounting system.

Although the institution should have monitored expenses from the revenue sharing fund more closely, there was no irregularity in the procedure followed as it is standard procedure to charge payroll to Federal Revenue Sharing appropriations until they are expended, before using General Fund dollars.

The correcting entry has been submitted to properly charge the general fund for the balance.

The institution intends to monitor expenses more closely and to be as timely as possible in submitting entries to the state accounting office for inclusion in the SBAS. The Department believes that the time frame at year-end renders inclusion of all transactions by the SBAS deadline impossible for most institutions.

Proper Recognition of Expenses

Recommendation - Page 21

If additional supplies are needed in excess of the budget, the school should follow the State procedure by submitting a budget amendment request.

The institution will follow state procedures by submitting budget amendment requests where indicated.

Expenditure Cut-off at Year End

Comment: The Department and the institution fully support the suggestion concerning continuing appropriations. The Department has been active in discussing the needs for continuing appropriation and the possibilities of addressing those needs by continuing appropriations with suitable state agencies. The Department agrees that their use would alleviate the year-end workload and also, would provide a means of more effective and efficient accounting for grants.

Suggestion - Page 22

We suggest that all agencies be instructed to obtain accurate cut-offs as of June 30, in the July cut-off and all appropriations for the prior year closed as of that time unless special authorization for a continuing appropriation is obtained.

This suggestion is addressed to the Department of Administration and the Office of Budget and Program Planning. These agencies will be contacted.

Payroll

Suggestion - Page 22

To strengthen internal control in the area of payroll we suggest payroll warrants coming from central payroll should not be returned to the person preparing the payroll, but delivered to a different person who would be responsible for delivering the payroll warrants. This individual

should personally deliver the warrants to each employee or have the employees pick up the warrants from the individual at a central point.

To strengthen internal control the institution does plan to do test checks of warrant distribution. That function will be assigned to an employee unrelated to the payroll function and will be carried out on a periodic basis.

Suggestion - Page 22

Payroll warrants should not be released until the payroll clerk and one other responsible official have reviewed the payroll and are satisfied the payroll is correct. The individuals reviewing the payroll should initial the payroll run as an indication of their review.

A procedure for reviewing the payroll and verifying its correctness prior to distribution will be developed.

Personnel Files

Suggestion - Page 23

We suggest the school start placing these items in the personnel file for ease of review and a complete history of each individual.

Pertinent employee information will be included in the personnel file.

Interest Income from the Legacy and Trust Fund

Recommendation - Page 23

An effort should be made by the various State departments involved to get the interest income from the legacy and trust fund recorded in the proper year at year end.

The Department will contact the appropriate departments regarding notification of interest income at year-end.

Reserve for Encumbrances

Comment: The Department has been concerned about the commingling of actual liabilities with encumbrances. The Department has promoted the auditor's suggestion that the Reserve for Encumbrances account be left as a separate line item in the general ledger. The use of the Reserve method would eliminate flexibility and individual adaptation of the current method to the agency's needs.

Suggestion - Page 23

We suggest that reserve for encumbrances be left as a separate line item in the general ledger at year end with a separate detail run of outstanding encumbrances supporting the line item.

This suggestion is addressed to the Department of Administration and will be referred to them.

Audit Trail of Statewide Budgeting and Accounting System

Comment: The Department and the institution support this suggestion. Also, the results of the Office of the Legislative Auditor's study will be helpful in determining the usefulness and adaptability of SBAS reports to individual agencies.

Recommendation - Page 23

We feel the audit trail could be greatly improved if the general ledger was set up on a more conventional basis that reflects by general ledger account: the balance previous month; individual debits and credits to the account with references to the source run or source document; and balance at the end of the month.

This recommendation is directed to the Department of Administration and will be referred to them.

U.S.D.A. Donations

Recommendation - Page 24

Although these donations were not material in fiscal 1975, we feel the school should record these donations at fair market value at the time of receipt and also record the related expense.

The Department is working with the Office of Budget and Program Planning and the Department of Administration to design a procedure to implement this recommendation.

Contact with Local Creamery

Suggestion - Page 24

We suggest that the school obtain the necessary approval for this agreement (with a creamery to trade cream for ice cream) from the State and in the future obtain approval before entering into any similar barter type transactions.

A copy of this agreement is being forwarded to the Department for review and approval. In the future, all such contracts will be given prior review and approval by the Department.

Employee Meals

Suggestion - Page 24

We suggest this benefit be incorporated in the employee handbook.

The Department and the institution feel that there would be no problem involved in incorporating this benefit in the employee handbook.

Recommendation - Page 24

We feel the cost of these meals should be recorded as an employee benefit in personnel services of each program rather than as a cost of the food program.

The Department has deliberated at length in the matter of listing employee meals as an employee benefit in personnel services rather than as a cost of the food program.

The concept is very sound, but several agencies will have to be involved to determine implementation.

